Taxing the Deceased Farmer

October 2003

Introduction

It is important for farmers and others involved in business to understand the potential tax liability associated with their estate plans. When a farmer dies, farm property can, in most cases, be transferred to other family members (including children and grandchildren) without incurring significant tax.

This article will help individuals organizing their estate understand the major areas of concern from a tax planning point of view.

Compliance

A final tax return (or terminal period return) must be filed for the period from January 1 of the year of death, to the actual date of death. All income earned during this period is included on this return. Income earned (by the estate) after the date of death may be reported on a Trust Income Tax and Information Return (Form T3).

The Income Tax Act has three significant features relevant to the filing of the terminal period return:

1. All capital assets are deemed to be sold immediately prior to death, unless rolled over to a spouse, common-law partner, spousal trust or common-law partner trust.
2. All registered assets (e.g., RRSPs and RRIFs) are included in income on the terminal period return, unless rolled over to a spouse, common-law partner or (under certain conditions) dependent children.
3. Earned income on the terminal period return includes *rights or things*, unless the legal representative of the estate elects to file a *rights or things return* (see below). Rights or things are amounts not paid at the time of death that would have been included in income when received, had the person not died. For farmers who file their tax returns on a cash basis, rights or things include supplies on hand, accounts receivable, crops inventory, livestock inventory (not part of a basic herd), and may include standing crop.

For farmers and other business operators, the terminal period return and any balances owing are due on or before the following dates:

(When death occurs between January 1 to December 15)
Due date for the return – June 15 of the following year

(When death occurs between December 16 to December 31)
Due date for the return – Six months after the date of death

Tax Planning

The Income Tax Act provides a number of special considerations that may assist in minimizing or reducing tax.

Optional returns – In addition to the terminal period return, three optional (or elective) returns may be filed:

1. **Rights or things return**
   As mentioned earlier, rights or things for farmers include such items as livestock and crops inventory. The legal representative for the estate may choose to file a separate return, reporting as income, the value of rights or things owned by the deceased at the time of death. Upon choosing this option however, all rights or things must be included on the rights or things return. They cannot be split between the terminal period return and the rights or things return. Alternatively, the legal representative may transfer or distribute the rights or things (or a portion thereof) to the beneficiary(s) of the estate, reporting the associated income when sold, on the beneficiary's tax return.

   The rights and things return must be filed, and amounts owing to Revenue Canada (CCRA) must be paid by the following date (whichever comes later):

   - 90 days after CCRA mails any Notice of Assessment or Notice of Reassessment for the terminal period return; **or**
   - One year after the date of death.

Taxing the Deceased Farmer

October 2003

Introduction

It is important for farmers and others involved in business to understand the potential tax liability associated with their estate plans. When a farmer dies, farm property can, in most cases, be transferred to other family members (including children and grandchildren) without incurring significant tax.

This article will help individuals organizing their estate understand the major areas of concern from a tax planning point of view.

Compliance

A final tax return (or terminal period return) must be filed for the period from January 1 of the year of death, to the actual date of death. All income earned during this period is included on this return. Income earned (by the estate) after the date of death may be reported on a Trust Income Tax and Information Return (Form T3).

The Income Tax Act has three significant features relevant to the filing of the terminal period return:

1. All capital assets are deemed to be sold immediately prior to death, unless rolled over to a spouse, common-law partner, spousal trust or common-law partner trust.
2. All registered assets (e.g., RRSPs and RRIFs) are included in income on the terminal period return, unless rolled over to a spouse, common-law partner or (under certain conditions) dependent children.
3. Earned income on the terminal period return includes *rights or things*, unless the legal representative of the estate elects to file a *rights or things return* (see below). Rights or things are amounts not paid at the time of death that would have been included in income when received, had the person not died. For farmers who file their tax returns on a cash basis, rights or things include supplies on hand, accounts receivable, crops inventory, livestock inventory (not part of a basic herd), and may include standing crop.

For farmers and other business operators, the terminal period return and any balances owing are due on or before the following dates:

(When death occurs between January 1 to December 15)
Due date for the return – June 15 of the following year

(When death occurs between December 16 to December 31)
Due date for the return – Six months after the date of death

Tax Planning

The Income Tax Act provides a number of special considerations that may assist in minimizing or reducing tax.

Optional returns – In addition to the terminal period return, three optional (or elective) returns may be filed:

1. **Rights or things return**
   As mentioned earlier, rights or things for farmers include such items as livestock and crops inventory. The legal representative for the estate may choose to file a separate return, reporting as income, the value of rights or things owned by the deceased at the time of death. Upon choosing this option however, all rights or things must be included on the rights or things return. They cannot be split between the terminal period return and the rights or things return. Alternatively, the legal representative may transfer or distribute the rights or things (or a portion thereof) to the beneficiary(s) of the estate, reporting the associated income when sold on the beneficiary's tax return.

   The rights and things return must be filed, and amounts owing to Revenue Canada (CCRA) must be paid by the following date (whichever comes later):

   - 90 days after CCRA mails any Notice of Assessment or Notice of Reassessment for the terminal period return; **or**
   - One year after the date of death.

Manitoba Agriculture and Food is Committed to
Your Future in Farming

Manitoba
Building for the Future

2. **Business income from a partner or proprietor return**
   A person may be a partner or a sole proprietor of a business with a fiscal year different from the calendar year. If death occurs after the end of the business fiscal year, but before the end of the calendar year, an optional return may be filed. On this return, income from the business for the period between the end of the fiscal year and the date of death, will be reported. If this optional return is not filed, all income must be reported on the terminal period return.

   This optional return must be filed and amounts owing must be paid by the time the terminal period return is due.

3. **Income from a testamentary trust return**
   A person may be receiving income from a testamentary trust with a fiscal period that differs from the calendar year. A testamentary trust is a legal arrangement created within a will, giving control of property to a person or institution (the trustee) for the benefit of beneficiaries. In this case, upon the death of a beneficiary, an optional return may be filed to include income from the trust for the period between the trust's fiscal year end and the date of death.

   This optional return must be filed and amounts owing must be paid by the following date (whichever comes later):

   - April 30 of the year following the year of death; **or**
   - six months after the date of death.

Tax Credits – By filing one or more of the optional returns, various deductions or tax credits may either be used more than once on separate returns, or split between returns. Amounts that can be claimed in full on each optional return, and on the final return, include:

- the basic personal amount
- the age amount
- the amount of the spouse or common-law partner
- the equivalent-to-spouse amount
- amounts for infirm dependents, age 18 or older

Amounts that can be split between the final return and the optional return(s) include:

- tuition fees, charitable donations and medical expenses

The following amounts cannot be claimed on an optional return:

- amounts transferred from a spouse, the capital gains deduction, childcare expenses, and losses from other years

Deemed Disposition of Capital Property

Upon death, a person is considered to have disposed of depreciable and non-depreciable capital property, even though a sale did not take place. This is referred to as a **deemed disposition**. Likewise, any proceeds received from the deemed disposition are referred to as **deemed proceeds**.

The deemed proceeds for non-depreciable assets, such as farmland, are their fair market value right before death – unless the assets are transferred to a spouse, spousal trust, common-law partner or common-law partner trust. In these cases, transfer may take place at the deceased's adjusted cost base, or alternatively, at any value between its adjusted cost base and fair market value immediately before death – resulting in a capital gain. It may be advisable to report such a capital gain on the terminal return to make use of the capital gains exemption or to offset a net capital loss. The amount used as the deemed proceeds on the terminal period return, becomes the adjusted cost base for the beneficiary(s).

The deemed disposition of depreciable property, such as buildings and equipment, can result in a recapture of **capital cost allowance (CCA)** or a terminal loss. A recapture of CCA will occur if the fair market value of the property (within a particular class) exceeds its **undepreciated capital cost (UCC)**. This recapture is included as income on the deceased's terminal return. If the fair market value of the property (within a particular class) is less than its UCC, a terminal loss is deducted from other income on the terminal return.

Special rules apply if the depreciable property is transferred to a spouse, spousal trust, common-law partner or common-law partner trust. They involve calculating a 'special amount' as the deemed proceeds, so that any recapture of CCA or terminal loss is deferred to the beneficiary(s) when they dispose of the property. This 'special amount' is the lesser of the following two options:

1. the capital cost of the property of the deceased; or
2. the result of the following calculation:

$$\frac{\text{Capital Cost of the Property}}{\text{Capital Cost of the Property (in the same class) that had not been previously disposed of}} \times \text{Undepreciated capital cost of all the deceased's property in the same class}$$

If the special amount is not used, the deemed proceeds are equal to the asset's fair market value right before death. **This choice must be made when the terminal return for the deceased is filed.**

104-00823/

Farm property (land and other depreciable assets) may be rolled over to a child, again using a 'special amount' as deemed proceeds. The definition of a child includes:

- the deceased's natural or adopted child
- a child of the deceased's spouse or common-law partner
- the deceased's grandchild or great-grandchild
- a person who, while under 19, was in the deceased's custody and control, and was wholly dependent on the deceased for support
- the spouse or common-law partner of any of the above

To be allowed to use the special amount as the deemed proceeds, all four of the following conditions must be met:

1. The farm property is in Canada.
2. Before the deceased's death, the deceased, the deceased's spouse or common-law partner, or any child of the deceased was using the farm property for farming on a regular basis.
3. The child was a resident of Canada right before the deceased's death.
4. The child has the right to absolute ownership of the farm property within 36 months of the date of death.

If these conditions are met, land may be transferred to a child at the deceased's adjusted cost base or at any value between the adjusted cost base and market value. *This also applies to shares in a family farm corporation or an interest in a family farm partnership.* It may be advisable to report a capital gain to make use of the capital gains exemption or to offset a net capital loss.

The depreciable property may be transferred to a child using a 'special amount'. This amount is the lesser of the following two options:

1. The capital cost of the property of the deceased; or
2. The result of the following calculation:

$$\frac{\text{Capital Cost of the Property}}{\text{Capital Cost of the Property (in the same class) that had not been previously disposed of}} \times \text{Undepreciated capital cost of all the deceased's property in the same class}$$

While this article provides an overview of some of the tax implications of death, it does not replace the need for advice from a qualified tax professional. Sound accounting (and legal) advice is a highly worthwhile investment and will assist in avoiding unnecessary taxes when planning one's estate.

2. **Business income from a partner or proprietor return**
   A person may be a partner or a sole proprietor of a business with a fiscal year different from the calendar year. If death occurs after the end of the business fiscal year, but before the end of the calendar year, an optional return may be filed. On this return, income from the business for the period between the end of the fiscal year and the date of death, will be reported. If this optional return is not filed, all income must be reported on the terminal period return.

   This optional return must be filed and amounts owing must be paid by the time the terminal period return is due.

3. **Income from a testamentary trust return**
   A person may be receiving income from a testamentary trust with a fiscal period that differs from the calendar year. A testamentary trust is a legal arrangement created within a will, giving control of property to a person or institution (the trustee) for the benefit of beneficiaries. In this case, upon the death of a beneficiary, an optional return may be filed to include income from the trust for the period between the trust's fiscal year end and the date of death.

   This optional return must be filed and amounts owing must be paid by the following date (whichever comes later):

   - April 30 of the year following the year of death; **or**
   - six months after the date of death.

Tax Credits – By filing one or more of the optional returns, various deductions or tax credits may either be used more than once on separate returns, or split between returns. Amounts that can be claimed in full on each optional return, and on the final return, include:

- the basic personal amount
- the age amount
- the amount of the spouse or common-law partner
- the equivalent-to-spouse amount
- amounts for infirm dependents, age 18 or older

Amounts that can be split between the final return and the optional return(s) include:

- tuition fees, charitable donations and medical expenses

The following amounts cannot be claimed on an optional return:

- amounts transferred from a spouse, the capital gains deduction, childcare expenses, and losses from other years

Deemed Disposition of Capital Property

Upon death, a person is considered to have disposed of depreciable and non-depreciable capital property, even though a sale did not take place. This is referred to as a **deemed disposition**. Likewise, any proceeds received from the deemed disposition are referred to as **deemed proceeds**.

The deemed proceeds for non-depreciable assets, such as farmland, are their fair market value right before death – unless the assets are transferred to a spouse, spousal trust, common-law partner or common-law partner trust. In these cases, transfer may take place at the deceased's adjusted cost base, or alternatively, at any value between its adjusted cost base and fair market value immediately before death – resulting in a capital gain. It may be advisable to report such a capital gain on the terminal return to make use of the capital gains exemption or to offset a net capital loss. The amount used as the deemed proceeds on the terminal period return, becomes the adjusted cost base for the beneficiary(s).

The deemed disposition of depreciable property, such as buildings and equipment, can result in a recapture of **capital cost allowance (CCA)** or a terminal loss. A recapture of CCA will occur if the fair market value of the property (within a particular class) exceeds its **undepreciated capital cost (UCC)**. This recapture is included as income on the deceased's terminal return. If the fair market value of the property (within a particular class) is less than its UCC, a terminal loss is deducted from other income on the terminal return.

Special rules apply if the depreciable property is transferred to a spouse, spousal trust, common-law partner or common-law partner trust. They involve calculating a 'special amount' as the deemed proceeds, so that any recapture of CCA or terminal loss is deferred to the beneficiary(s) when they dispose of the property. This 'special amount' is the lesser of the following two options:

1. the capital cost of the property of the deceased; or
2. the result of the following calculation:

$$\frac{\text{Capital Cost of the Property}}{\text{Capital Cost of the Property (in the same class) that had not been previously disposed of}} \times \text{Undepreciated capital cost of all the deceased's property in the same class}$$

If the special amount is not used, the deemed proceeds are equal to the asset's fair market value right before death. **This choice must be made when the terminal return for the deceased is filed.**

Farm property (land and other depreciable assets) may be rolled over to a child, again using a 'special amount' as deemed proceeds. The definition of a child includes:

- the deceased's natural or adopted child
- a child of the deceased's spouse or common-law partner
- the deceased's grandchild or great-grandchild
- a person who, while under 19, was in the deceased's custody and control, and was wholly dependent on the deceased for support
- the spouse or common-law partner of any of the above

To be allowed to use the special amount as the deemed proceeds, all four of the following conditions must be met:

1. The farm property is in Canada.
2. Before the deceased's death, the deceased, the deceased's spouse or common-law partner, or any child of the deceased was using the farm property for farming on a regular basis.
3. The child was a resident of Canada right before the deceased's death.
4. The child has the right to absolute ownership of the farm property within 36 months of the date of death.

If these conditions are met, land may be transferred to a child at the deceased's adjusted cost base or at any value between the adjusted cost base and market value. *This also applies to shares in a family farm corporation or an interest in a family farm partnership.* It may be advisable to report a capital gain to make use of the capital gains exemption or to offset a net capital loss.

The depreciable property may be transferred to a child using a 'special amount'. This amount is the lesser of the following two options:

1. The capital cost of the property of the deceased; or
2. The result of the following calculation:

$$\frac{\text{Capital Cost of the Property}}{\text{Capital Cost of the Property (in the same class) that had not been previously disposed of}} \times \text{Undepreciated capital cost of all the deceased's property in the same class}$$

While this article provides an overview of some of the tax implications of death, it does not replace the need for advice from a qualified tax professional. Sound accounting (and legal) advice is a highly worthwhile investment and will assist in avoiding unnecessary taxes when planning one's estate.

For Further Information Contact Your Local Manitoba Agriculture and Food Office.

Prepared By:
Robert McKenzie, P.Ag.
Farm Management Specialist

Scott Stothers, P.Ag.
Farm Management Specialist